Macroeconomic Developments in Serbia

July 2019
Sustained Macroeconomic Stability

- In six years, Serbia has transformed to a low inflation and stable growing economy, with fiscal surplus, declining public debt, significantly reduced external imbalances and labour market recovery.
- GDP growth in 2018 (highest in a decade) was driven by investments and exports, as well as labour market recovery. Growth trend continues in Q1 and Q2 2019, despite global slowdown.
- After moving at an average level of 2.0% in 2018 and finishing the year at the same level, inflation continues to move in the lower half of the target tolerance band (1.5% y/y in June), in line with NBS forecast. Throughout the forecast horizon, inflation is expected to move within the target tolerance band, more likely in its lower half. Inflation expectations are anchored around the central target point (3%).
- Government budget posted a surplus in 2017 and 2018 (1.1% and 0.6% of GDP, respectively), and the same trend continued in Q1 2019 (surplus of 0.9% of GDP). As a result public debt share declined by over 18 pp of GDP (cumulative) since its peak in 2015, with an improved currency composition after repayment of two Eurobonds (USD 1.75 bn), and refinancing of additional USD 1.1bn on international markets in June.
- Macroeconomic stabilization and improvements to the business environment contributed to sustained FDI growth (EUR 1.4bn in the five months of 2019), mainly directed to export-oriented sectors.
- Exports of goods and services retained their growth momentum in early 2019 (11.9 % y/y in Jan-May), driven by exports of manufactured goods, services and agriculture.
- Results were acknowledged by improved credit ratings (S&P, Fitch and Moody’s) during 2017 and additionally improved outlook in 2018 (S&P), by successful completion of a precautionary SBA with the IMF and a sharp decline in the country risk premium (historic low in July 2019). In 2018 a Policy Coordination Instrument with the IMF has been approved, with successfully completed first review.
- The NBS decided to cut the key policy rate in July 2019, to its new lowest level of 2.75%, thereby providing additional support to economic growth. Led by demand and supply factors, lending activity increased 9.8% y/y in May 2019 (9.9% end-2018).
- Banking sector stability has been preserved and further reinforced. Encouraged by the NBS measures, the share of NPLs in total loans declined to 5.4% at end-May 2019, which is the lowest level since 2008 when this indicator of portfolio quality was introduced. Capital adequacy indicators are even stronger after the application of Basel III standards in Serbia.
Low Inflationary Pressures

Inflation profile similar to advanced economies

After reaching its target midpoint in April...

- Inflation is kept firmly in check, moving around 2% on average in the past five years.
- After approaching the central target point, y/y inflation declined to 1.5% in June.
- Inflation movement from the beginning of the year was mainly led by unprocessed food prices.
- Core inflation is moving close to the lower bound of the target tolerance band, indicating low cost and demand-side pressures.

... inflation will be trending downward towards the lower target bound by mid-2020, only to start its gradual return to target midpoint thereafter.

- Slowdown in inflation will be determined by the high base effect for vegetables, while growth of aggregate demand, waning of the effects of past appreciation and faster growth of administered prices in 2019 will work in opposite direction.
- Risks are assessed to be symmetric and related to developments in the global commodity and financial markets and, to some extent, to administered prices.
Inflation Expectations Well Anchored Around the Inflation Target

Short-term inflation expectations of financial institutions are anchored around NBS target …

…same as medium-term inflation expectations

- Short-term expectations of the financial sector and corporates have been moving within the target band for five years.
- According to Ipsos’ June survey, one-year ahead inflation expectations of the financial sector are 2.8% (May 3.0%).
- According to Bloomberg’s July survey, expectations of the financial sector are also slightly lower 2.9% (June 3.0%).

- Medium-term expectations of the financial sector are firmly anchored on target, indicating a high level of trust in the commitment and ability of the NBS to achieve its primary goal.
- From the beginning of 2019, financial sector and corporates’ two-year ahead inflation expectations are just about the central inflation target of 3.0%.
- Medium-term expectations of the financial sector have been moving within the target tolerance band since their monitoring began.
Strong GDP Growth on the Back of Robust Investment Activity, Exports and Labour Market Recovery

Economy resilient in Q1 and Q2 2019

- Alongside signs of recovery across Europe, GDP advanced 0.9% in Q1 (q/q), driven by all key sectors with construction and fixed investment beating expectations.
- Quarterly growth in Q2 is expected to pick up further to 1.5% q/q and remain robust throughout the year, leading to annual growth of 3.5% in 2019.
- Acceleration of growth in Q2 will be driven by construction, fixed investment and net exports performance.
- After slowing down in the late 2018, manufacturing output is recovering and is expected to contribute to growth in 2019.

In the coming years Serbia will maintain a strong, sustainable and broad-based growth

- Risks to GDP growth arise from global economic activity slowdown, as well as monetary policies of leading CBs and commodity prices. On the other hand, domestic factors will continue to provide strong support to economic growth, which is why we estimate risks to projection as symmetrical.
- Factors to support sustainable medium-term growth of around 4% include macroeconomic stability, improved business environment, strong private and public investment and effects of past monetary easing.
The New Investment Cycle

Preceded by achieved macroeconomic stability, new investment cycle began in 2015...

During the 2015-2018, fixed investments grew at an average rate of around 7%, with cumulative growth of around 30%.

In 2018 investment growth picked up to 9.2% providing a key contribution to higher-than-expected GDP growth.

Indicators suggest that investment growth will likely pick up to around 10% y/y in the first half of 2019, as a result of growth in both private and government sector.

The share of investment in GDP reached 20.2% in 2018, and that share will continue to grow in the medium term.

In the medium-run, investments will contribute to further rebalancing of the economy.

• Sustained macroeconomic stability, improvement in the overall business environment, rising profitability and EU accession process will work in favour of private investments in the coming years.

• Aside from private investments, public sector investments recovered as of 2015 and picked up particularly in 2018.

• A growing economy, combined with improved tax collection and responsible public spending policies, will enable the government to increase investment activity and further develop the country’s infrastructure.
Macroeconomic stability combined with structural reforms has created a more favourable climate for FDIs...

...which are well-diversified and contributing to the country’s export potential

- Net FDIs amounted to EUR 3.2bn in 2018, marking one of the best years on record and outperforming the projection.
- In the five months of 2019 net FDI inflow increased further (14.6% over last year's high base), reaching EUR 1.4bn.
- The largest part of net FDIs in 2019 were outright equity transactions, followed by reinvested earnings.
- We expect a continuance of strong performance in 2019, with net FDI inflows projected at 5.3% of GDP (EUR 2.4bn).
- During 2013 – 2018 an increasing share of FDI inflows has been directed to export-oriented sectors.
- Within manufacturing, most FDI inflows are directed to the automobile, base metals, food/beverage and chemical industries. This resulted in high growth of manufacturing employment, output and exports.
- FDI inflows are diversified by region of origin as well, with a greater share of countries from the Asia Pacific and Middle East regions, alongside Serbia’s major investment partner - the European Union.
Export growth largely continues despite Eurozone slowdown…

…but investment and oil-related imports temporarily raised the deficit in 2017 and 2018

- During 2018 CAD amounted to EUR 2.2bn (5.2% of GDP—unchanged from the previous year).
- Goods and services exports grew 11.9% in the five months of 2019 driven by exports of manufactured goods (+6.7 y/y), services (+17.6 y/y), and agricultural products. Eurozone demand moderation was partly compensated by increasing exports to CEE markets.
- Imports of goods and services grew 13.4% y/y in the same period, mostly on account of by higher imports of capital and intermediate goods.

- As of 2017 an increase in CAD / GDP ratio was recorded due to higher imports of capital and intermediate goods related to investment and industrial activity, higher oil prices as well as further growth in domestic demand.
- Since 2015 Serbia’s current account deficit has been fully financed by net FDI, an indicator of long-term external sustainability.
- In the medium term, we expect CAD to be around 4-5% of GDP, while FDI inflows will remain more than sufficient to finance the CAD.
Favourable Fiscal Performance Continues

Strong fiscal adjustment since 2015 of around 8pp of GDP...

...resulted in a decline in the public debt-to-GDP ratio and its sustainability

- Improvement of the fiscal outlook in last four years was led by fiscal consolidation on expenditure side, and robust growth in revenues on account of GDP growth and improved tax collection.
- Fiscal balance remained in surplus in 2018 (0.6% of GDP) and the positive trend continues in Q1 2019 with a surplus of 0.9% of GDP.
- Public investments growth in 2018 was around 50% y/y, reaching 3.9% of GDP and exceeding the projections from the Fiscal strategy, and double-digit growth continued in Q1 2019.
- The declining trend of public debt continued in 2019 (51.8% of GDP in May).
- The Government’s Fiscal Strategy entails a medium-term deficit target of 0.5% of GDP, consistent with steady debt reduction and sustainability.
- Public debt dinarisation picked up from 20.9% (end-2016) to 25.9% in May 2019 due to two Eurobond repayments (USD 1.75 bn).
- In June Serbia issued a 10yr EUR 1bn Eurobond at 1.62% and repaid USD-denominated bonds in the same amount, thereby reducing exchange rate and rollover risk.
Improved Structural Competitiveness Provided Additional Boost to Overall Macroeconomic Performance

Key reform areas in the last four years:

- Construction sector;
- Labor market;
- Tax administration;
- Financial sector;
- Contract enforcement and resolving insolvency.

Key deliverables:

- Law on Planning and Construction (2014) and Law on Investment (2015) – streamlined construction permit procedures (one-stop-shop and electronic construction permits), doubling the number of construction permits and increasing the share of construction in GDP.

- New Labor Law (2014) – improved flexibility and job creation. On top of that, the National Employment Strategy & Reform Program improved job matching services and training and provided subsidies to disadvantaged people and self-employment. Reforms contributed to an increase in private sector employment by more than 200 thousand people (16.4%), almost half of which in manufacturing industry, followed by private sector services and the construction sector.

- Tax Administration reform – led to a significant increase in revenue collection and better than planned fiscal results.

- NPL Resolution Strategy (NBS and government action plans) – the share of NPLs declined more than 70% (from 22.2% in August 2015 to 5.4% in May 2019). Narrowing was most evident with corporates – the share of NPLs was reduced from 25.9% to 5.0% in the same period.

- Private bailiff system (2013) and New Bankruptcy Law (2014).
Key Policy Rate Cut to 2.75%, its Lowest Level Yet

The key policy rate cut to 2.75%, its lowest level in the inflation targeting regime

FX required reserve ratio has remained unchanged since early 2016

• The decision takes into account the following factors:
  • Inflation is expected to move in the target tolerance band in the coming period, most probably in its lower part.
  • Internationally, slower growth and lower-than-expected inflation contributed to slower pace of normalization or a new round of monetary easing of leading central banks, most likely with positive impact on capital flows to emerging markets.
  • Serbian economy’s resilience to potential negative effects from the international environment has increased owing to the narrowing of internal and external imbalances and favorable macroeconomic prospects going forward.

• Last time FX RR ratio was reduced in early 2016 aiming to support lending activity (to 20%/13%, for liabilities up to/over 2Y).
• RR is an important monetary policy tool (in June 2019 RR amounted to EUR 1.9 bn and RSD 179.4bn ).
• NBS uses RR as an important macroprudential tool within dinarisation strategy:
  - by applying lower RR ratio on dinar vs FX sources,
  - by applying remuneration at higher rate on dinar RR vs FX RR (i.e. 1.25% on RSD RR, while no remuneration is applied on FX RR).
The Effects of NBS Monetary Policy are Reflected in Lower Costs of Government and Private Sector Financing

Interest rates on dinar government securities have slided to new minimums …

… while interest rates on private sector loans are close to their lowest levels

- Chart 18: Interest rates in the primary market of government securities (p.a., in %)

  - The yield rate fall is accompanied by an extension of the yield curve maturity to 10 years; the weighted average interest rate on domestic bonds has dropped from 13.7% (Dec 2012) to 5.7% (July 2019), with the share of long-term securities (5+ year maturity), increasing from 2% to over 70%.

- Chart 19: Interest rates on loans – new business (3 months moving average, in %)

  - During 2019 Serbia has issued benchmark bonds (maturity of 3 and 7 years); in the latest auctions, (June and July), yields fell to 3.4% and 3.6%, respectively, with growing interest of non-residents for long-term dinar securities.

  - Successful Eurobond issuance (EUR 1 bn, 10y, yield of 1.62%) in June 2019 has confirmed the investors confidence in undertaken reforms in previous years.

- Since the beginning of monetary policy relaxation cycle (May 2013), dinar lending interest rates fell sharply. In May 2019, dinar interest rate for corporate sector stood at 5.1% (down by 11.4 pp), and for households at 10.0% (down by 10.6 pp).

- The servicing costs of outstanding credit amounts have also been reduced, leading to higher disposable income for consumption and investments, of both households and corporates.

- In the observed period, a sharp fall in the country risk premium and monetary easing by the ECB contributed to the fall in EUR-indexed lending rates.
... as well as to Growth of Credit Activity

Lower costs of financing and sustainable economic growth support domestic lending ...

• In May 2019, domestic lending growth reached 9.8% y/y (9.9% at end-2018), led by corporate and households lending, which rose by 8.3% and 11.2% y/y, respectively.

• Banks continued with their NPL resolution efforts - excluding the effect of NPL write-offs and sales, total lending growth reached 11.4% y/y in May 2019 (10.8% y/y to enterprises and 11.9% y/y to households).

• Further growth of lending activity is expected in the coming period, as a result of sustainable economic growth, improved conditions in the labor market, effects of past monetary policy easing by the NBS, low interest rates in the euro area, interbank competition and reduced NPLs.

... and the positive tendencies in the credit market are also confirmed by the results of the bank lending survey

In May 2019, domestic lending growth reached 9.8% y/y (9.9% at end-2018), led by corporate and households lending, which rose by 8.3% and 11.2% y/y, respectively.

• Banks continued with their NPL resolution efforts - excluding the effect of NPL write-offs and sales, total lending growth reached 11.4% y/y in May 2019 (10.8% y/y to enterprises and 11.9% y/y to households).

• Further growth of lending activity is expected in the coming period, as a result of sustainable economic growth, improved conditions in the labor market, effects of past monetary policy easing by the NBS, low interest rates in the euro area, interbank competition and reduced NPLs.

- After relaxation in 2017 and H1 2018 corporate lending standards remained unchanged. Competition in the sector and positive expectations regarding the economic outlook should contribute to further easing of standards in Q2 2019. Similar conditions prevail in the household sector.

- Corporate credit demand is driven by SMEs, while households are mostly interested in housing and cash loans.

- Main factors driving credit demand of corporate / household sector are Capex and working capital financing needs / real estate acquisition and refinancing of liabilities.
Positive Prospects for Serbia Credit Rating Improvement and Investor Confidence Growth

After reaching its all-time low at the beginning of July 2019, Serbia’s risk premium remains among the lowest in the region

The dinar remained relatively stable against the euro in 2018 and since the start of 2019

- The risk premia of emerging countries fell in June, influenced by a downturn in global trade tensions. At the beginning of July, Serbia's risk premium recorded **a new minimum since this indicator has been followed**, thus confirming investor confidence.

- **Relatively low risk premium** is primarily the result of the positive effects of domestic factors – multiyear narrowing in internal and external imbalances and favorable macroeconomic achievements and growth outlook.

- In December 2018 **S&P improved outlook from 'stable' to 'positive'** and affirmed that in June 2019, keeping rating at BB.

- Fitch affirmed rating at BB with stable outlook for Serbia in May 2019, also sending a positive signal to investors.

- The appreciation pressures that prevailed in the previous two years, persisted dominant since the start of 2019 as well. Strengthening of the dinar is stimulated by better Serbia's fundamentals, good performance and favorable growth prospects, which contributed to FX inflow on account of FDI and portfolio investment, and also tourism receipts.

- In order to maintain the relative stability of the dinar, the National Bank of Serbia was buying FX in periods of strong and concentrated appreciation pressures, acting proactively and bolstering the FX reserves, thus increasing resilience of the domestic financial system to potential external shocks.

**Chart 22** EMBI risk premium (basis points, daily values)

**Chart 23** Exchange rate developments (31 December 2012 = 100)
Indicators of Dinarisation are on the Rise

Macroeconomic stability contributing to dinarisation process

The growth of dinar loans to households accompanied by higher dinar savings

- NBS stimulates the dinarisation process by delivering low and stable inflation, preserving relative exchange rate stability, enhancing management of FX risks and exposures in the private sector, and using other measures.
- The Government contributes to dinarisation through tax policy, by developing the dinar securities market (dinar debt share rose from 2.5% in 2008 to 25.9% in May 2019).
- Dinarisation of corporate and household sector deposits rose by 12.4 pp compared to end-2012 and currently stands at 31.8% (May 2019), while dinarisation of corporate and household sector receivables rose by 5.0 pp to 33.0% (May 2019).
- Over the past years, dinarisation of household receivables had a firm upward trend – an upsurge from 35.1% (2012) to the maximum of 54.1% (May 2019). This positive trend is a result of a sharp drop in dinar interest rates, low and stable inflation, as well as NBS measures aimed to support dinarisation.
- Dinar savings of households (residents) recorded strong growth of 22.2% in 2018, which also continued in 2019, when it increased to a new maximum of RSD 70 bn.
- Dinarisation process is additionally supported by the issuance of the dinar bonds by EBRD (December 2016) and Erste bank (February 2019).
Traditional Banking
Mostly Financed by Domestic Deposits

Adequate structure of banking sector assets

Improving the quality of the banking sector assets

Chart 26 Structure of banking sector assets (RSD bn)

Chart 27 Asset quality – Non-performing loans (NPL) (RSD bn, %)

Source: NBS

- Risk aversion during the crisis led to more intensive investments in low-risk state securities, which after 2015 stabilized at around of one-fifth of the total banking sector net assets (17.9% at the end of May 2019).
- Despite historical low levels of deposit rates, stability of retail and corporate deposits in funding mix is present, with share in total liabilities of 47% and 26%, respectively at the end of May 2019.
- Despite high loan portfolio euroization, currency matching of assets and liabilities is present, with net open position of 4.4% of regulatory capital at end of May 2019.

- Implementation of NPLs resolution measures together with the growth of credit activity led to a significant improvement of banks portfolio quality. The share of NPLs decreased to the lowest level since the 2008 when the definition and reporting requirements were introduced.
- At end-May 2019, the NPL ratio was 5.4%, with the maintenance of relatively high coverage by both, IFRS provisions (61.3%).
- The main channels for the NPLs reduction remained the write-off and transfer (sale) to third parties, with increasing contribution of repayment.
Conservative Framework Contributed to the Banking Sector Resilience to Shocks

High banking sector capitalisation as a result of strong prudential measures

- Banks possess significant capital reserves, which enable them to successfully deal with credit risk even in the case of worst-case stress scenario.
- In addition to the high level, the capitalization of the banking sector is characterized by a strong structure, with CET1 around 95% of total capital.
- The high solvency of the banking sector is also indicated by the leverage ratio, introduced in regulatory framework of the Republic of Serbia with Basel III implementation, which at the end of March 2019 amounted to 13.8%.

Serbian banking sector is highly liquid

- Liquidity ratios are constantly at levels significantly higher than the regulatory minimum.
- Liquid assets account for around 36.6 % of the total assets of the banking sector in May2019.
- The loan to deposit ratio that at the end of May 2019 amounted 92.8%, indicates stability of funding and in general the liquidity of the banking sector.
Structural slides
Reduced Food Price Volatility Contributing to Low and Stable Inflation

Chart 30 Contributions of CPI components to y/y inflation
(y/y rates, pp)

• Historically, short-term volatility of headline inflation was mainly driven by food prices.
• Core inflation remained low and stable hovering around 1% in 2018, confirming low inflationary pressures. In 2019, due to base effect, it slightly increased to 1.4% (June).
Growth Structure more Favourable than Pre-Crisis

Pre-crisis GDP growth was driven by consumption, the trend reversed after the crisis in favour of investments and exports.

In the next five years, Serbia will gradually converge towards more developed countries in terms of GDP composition.

- Prior to the crisis, high capital inflows led to consumption-based growth which resulted in increased external imbalances. With the first wave of the crisis, this trend reversed. Growth was slower, but more sustainable and driven by net exports and investments.

- Large-scale investments in the automobile and oil industries (2011–2012) have helped the economy to rebalance.

- The new investment cycle that began in 2015 is more diversified, and is leading to further rebalancing of the economy and sustainable growth.

- As a result of adequate policy mix, GDP growth will remain broad-based and sustainable.

- Consumption will continue to grow, but slower than the total GDP, creating space for more investment.

- In the medium-run, fixed investments will increase their share in GDP, while exports of goods and services are likely to approach 70% of GDP.

- Implementation of structural reforms, improvement in the investment climate and the EU accession process created a foundation for healthy growth.
Sustainable Recovery of the Labour Market

The unemployment rate declined in Q1 2019

- According to the Labour Force Survey for Q1 2019, the unemployment rate was 12.1%, which represents y-o-y drop by 2.7 p.p. The employment rate in the same period was 47.4% (y-o-y growth of 2.3 pp).
- The participation rate of the working age population in Q1 was 67.2%, which is y-o-y growth by 1.4 p.p.
- Favourable trends in the formal labour market come from the private sector, where employment increased by 14.8% (May 2019/December 2014) - mainly in manufacturing, private sector services and construction.

Stable growth in productivity of the Serbian economy

- Estimated growth in productivity of the Serbian economy is result of a faster growth of GDP than increase in employment from the beginning of 2018.
- In the last four years, the highest growth of productivity has been recorded in manufacturing branches with the largest FDI inflows - steel, chemical and pharmaceutical industries, as well as in rubber and plastics industry.
- Productivity growth in the same period is also noticeable in production of machinery and equipment, as well as in production of beverages.
Trading Partners and External Demand

Chart 35 Imports by country in 2018 (EUR mn)

Chart 36 Exports by country in 2018 (EUR mn)

Chart 37 External Demand Indicator (long-term average = 100)

Chart 38 Real Effective Exchange Rate Development (2005=100)

Source: European Commission, NBS

*Growth indicates appreciation.
Legal Framework for Banking Supervision

- **Domestic regulatory framework for banking supervision is based on Basel III standards:**
  - Set of by-laws implementing these standards on individual and consolidated level are applied as of 30 June 2017;
  - Since July 2017 further steps on harmonization of domestic legal framework with Basel III were made;
  - The main goals of implementing these standards are to increase the resilience of the banking sector by enhancing the quality of capital and introducing capital buffers, to increase the efficiency of monitoring and controlling banks' exposure to liquidity risk, further strengthening of the market discipline and transparency of banks' operation in the Republic of Serbia by publishing all relevant information on bank operation, as well as to bring the reporting system in line with the new regulatory arrangements
  - So far no issues have been identified in the application of Basel III standards;
  - NBS will continue to take regulatory activities in order to ensure alignment with EU acquis.

- In December 2017 **regulation governing risk management by banks was amended** with aim to improve the way bank deals with risks and enhance its Internal Capital Adequacy Assessment Process (ICAAP).

- Accounting and prudential regulations were timely adjusted in order to **enable the implementation of IFRS 9 in banks from 1st of January 2018.**

- Additionally, cooperation with supervisors of the home countries of banks present in Serbia is continuously developing and strengthening and regular communication with the ECB and EBA is maintained.
The Amendment of NPL Resolution Strategy by adoption of NPL Program for period 2018 - 2020

Effect of strategy on NPL stock

- Aggregate decrease of NPL level in August 2015 – May 2019 amounts to RSD 302.3 bn, while the effect of the NPL Strategy is mostly reflected through the historically lowest level of NPL ratio of 5.4% at end-May 2019. Compared with NPL ratio before the NPL Strategy entered into the force (22.25%) the decrease is clearly impressive at 16.9 p.p.

- Beside successful implementation of NPL Strategy, it is necessary to perform activities intended for resolution of remaining problems in order to provide the sustainability of achieved results. For that purpose, it is very important to create the ambient, which strives for early detection of sources and causes of NPLs, as well as, upgrading of existing institutes directed toward resolution of potentially new NPLs. Bearing that in mind, the Government of the Republic of Serbia on the December 27th 2018 implemented a Program for NPL resolution for period of 2018 – 2020 (Program for NPL).

- As a integral part of Program for NPL, Action plan focuses on subjects of:
  - resolution of non-performing claims of state-owned financial creditors, through assignment of claims and eventually write-off of remaining part of portfolio
  - improving bankruptcy framework, i.e. it`s upgrade as institute in non-performing claims resolution
  - series of activities that are directed to the prevention of emerging and accumulating of new NPLs
Capital Buffers – Implementation of Macroprudential Policy Measures

- Capital buffers increase the resilience of banks to losses, reduce excessive or underestimated exposures and restrict the distribution of capital.
- These macroprudential instruments should limit systemic risks in the financial system, which can be cyclical (capital conservation buffer and countercyclical capital buffer) or structural (capital buffer for a systemically important bank and systemic risk buffer).
- The following capital buffers are used in the Republic of Serbia:
  - Capital conservation buffer;
  - Countercyclical capital buffer, in order to mitigate and prevent excessive credit growth;
  - Capital buffer for a systemically important bank, with the objective to limit the systemic impact of misaligned incentives in terms of favoring certain financial institutions;
  - Systemic risk buffer, introduced to limit the risk of euroisation, one of the key structural non-cyclical systemic risks to the stability of the financial system of the Republic of Serbia.
- The capital conservation buffers may consist only of Common Equity Tier 1 capital equal to 2.5% risk-weighted assets for capital conservation buffer, 1% or 2% risk-weighted assets for capital buffer for systemically important banks, depending on the systemic importance level and 3% of total foreign currency and foreign currency-indexed placements of a bank approved to corporates and households in the Republic of Serbia for systemic risk buffer. Countercyclical buffer rate is set at 0%.
- Capital buffers apply as of 30 June 2017.
NPL Resolution Required a Systemic Approach – and, as Such, Gave Results

- NPL development after the adoption of the NPL Resolution Strategy, especially in 2017 and 2018, confirmed the soundness of the inter-institutional and coordinated approach envisaged by the Strategy.

- After 2018 drop in share of NPLs of 4.15 pp, noticeable downward trend continued in 2019, resulting with four times lower NPL ratio than it was at the time of Strategy adoption.

- Fall was widespread and recorded in all sectors, of which most prominent was within construction.

- The continuation of NPL resolution efforts by banks together with the recovery of credit activity, should further stimulate the decrease in the share of NPLs.

### NPL data, May 2019

<table>
<thead>
<tr>
<th></th>
<th>Gross loans (EUR bn)</th>
<th>Gross NPL (EUR bn)</th>
<th>NPL ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporates</td>
<td>8.7</td>
<td>0.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Natural persons</td>
<td>8.9</td>
<td>0.4</td>
<td>4.4</td>
</tr>
<tr>
<td>of which: households</td>
<td>8.0</td>
<td>0.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Corporates in bankruptcy proceedings</td>
<td>0.2</td>
<td>0.2</td>
<td>99.1</td>
</tr>
<tr>
<td>Other</td>
<td>1.9</td>
<td>0.1</td>
<td>5.3</td>
</tr>
<tr>
<td>Total</td>
<td>19.7</td>
<td>1.1</td>
<td>5.4</td>
</tr>
</tbody>
</table>
Serbia’s Economic Outlook

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP, y-o-y %</td>
<td>5.7</td>
<td>-2.7</td>
<td>0.7</td>
<td>2.0</td>
<td>-0.7</td>
<td>2.9</td>
<td>-1.6</td>
<td>1.8</td>
<td>3.3</td>
<td>2.0</td>
<td>4.3**</td>
<td>3.5</td>
</tr>
<tr>
<td>Private consumption, in %</td>
<td>4.5</td>
<td>-3.3</td>
<td>-0.6</td>
<td>1.4</td>
<td>-1.7</td>
<td>-1.7</td>
<td>-0.1</td>
<td>-0.3</td>
<td>1.3</td>
<td>1.9</td>
<td>3.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Private investment,¹ in %</td>
<td>14.4</td>
<td>-23.6</td>
<td>-7.9</td>
<td>7.5</td>
<td>15.1</td>
<td>-7.7</td>
<td>-5.6</td>
<td>3.5</td>
<td>2.7</td>
<td>10.1</td>
<td>3.5</td>
<td>4.1</td>
</tr>
<tr>
<td>Government consumption, in %</td>
<td>3.5</td>
<td>-1.7</td>
<td>0.0</td>
<td>1.6</td>
<td>0.4</td>
<td>-2.1</td>
<td>0.9</td>
<td>-3.7</td>
<td>1.2</td>
<td>3.3</td>
<td>3.6</td>
<td>3.3</td>
</tr>
<tr>
<td>Government investment, in %</td>
<td>-16.4</td>
<td>-16.6</td>
<td>0.0</td>
<td>-7.8</td>
<td>7.6</td>
<td>-35.8</td>
<td>13.6</td>
<td>14.0</td>
<td>22.0</td>
<td>-6.4</td>
<td>43.1</td>
<td>16.3</td>
</tr>
<tr>
<td>Exports, in %</td>
<td>12.6</td>
<td>-11.5</td>
<td>16.9</td>
<td>5.6</td>
<td>2.9</td>
<td>18.0</td>
<td>9.4</td>
<td>11.9</td>
<td>8.2</td>
<td>8.9</td>
<td>7.4</td>
<td>n/a</td>
</tr>
<tr>
<td>Imports, in %</td>
<td>10.1</td>
<td>-21.9</td>
<td>-0.1</td>
<td>7.2</td>
<td>-0.6</td>
<td>6.5</td>
<td>5.1</td>
<td>4.0</td>
<td>6.7</td>
<td>11.1</td>
<td>11.1</td>
<td>7.6</td>
</tr>
<tr>
<td>Unemployment Rate, in %⁴</td>
<td>13.6</td>
<td>16.1</td>
<td>19.2</td>
<td>23.0</td>
<td>23.9</td>
<td>22.1</td>
<td>19.2</td>
<td>17.7</td>
<td>15.3</td>
<td>13.5</td>
<td>12.7</td>
<td>n/a</td>
</tr>
<tr>
<td>Nominal Wages, in %⁵</td>
<td>18.0</td>
<td>9.0</td>
<td>7.6</td>
<td>11.2</td>
<td>9.0</td>
<td>6.2</td>
<td>1.4</td>
<td>-0.2</td>
<td>3.7</td>
<td>3.9</td>
<td>6.5</td>
<td>n/a</td>
</tr>
<tr>
<td>Money Supply (M3), in %</td>
<td>9.8</td>
<td>21.5</td>
<td>12.9</td>
<td>10.3</td>
<td>9.4</td>
<td>4.6</td>
<td>7.6</td>
<td>6.6</td>
<td>11.6</td>
<td>3.6</td>
<td>14.5</td>
<td>n/a</td>
</tr>
<tr>
<td>CPI,² in %</td>
<td>8.6</td>
<td>6.6</td>
<td>10.3</td>
<td>7</td>
<td>12.2</td>
<td>2.2</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
<td>3.0</td>
<td>2.0</td>
<td>chart 2</td>
</tr>
<tr>
<td>National Bank of Serbia Key Policy Rate,³ in %</td>
<td>17.8</td>
<td>9.5</td>
<td>11.5</td>
<td>9.8</td>
<td>11.3</td>
<td>9.5</td>
<td>8.0</td>
<td>4.5</td>
<td>4.0</td>
<td>3.5</td>
<td>3.0</td>
<td>2.75</td>
</tr>
<tr>
<td>Current Account Deficit BPM-6 (% of GDP)</td>
<td>20.0</td>
<td>6.3</td>
<td>6.5</td>
<td>10.3</td>
<td>10.9</td>
<td>5.8</td>
<td>5.6</td>
<td>3.5</td>
<td>2.9</td>
<td>5.2</td>
<td>5.2</td>
<td>5.0</td>
</tr>
</tbody>
</table>

¹ Excluding the effect of change in inventories
² Inflation figures in the table represent Dec on Dec inflation: (Pt/Pt-12)*100-100
³ Latest data
⁴ Labour Force Survey. Since 2014, data are revised according to the new LFS methodology.
⁵ Since 2017, nominal wages published according to the new methodology.
** SORS estimate based on sum of four quarters
### Serbia

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of banks(^1)</td>
<td>33</td>
<td>33</td>
<td>32</td>
<td>30</td>
<td>29</td>
<td>30</td>
<td>31</td>
<td>29</td>
<td>27</td>
<td>26</td>
</tr>
<tr>
<td>Employees</td>
<td>29,887</td>
<td>29,228</td>
<td>28,394</td>
<td>26,380</td>
<td>25,106</td>
<td>24,257</td>
<td>23,047</td>
<td>21,516</td>
<td>20,583</td>
<td>19,550</td>
</tr>
<tr>
<td>Branches</td>
<td>2,487</td>
<td>2,383</td>
<td>2,243</td>
<td>1,989</td>
<td>1,787</td>
<td>1,730</td>
<td>1,627</td>
<td>1,598</td>
<td>1,598</td>
<td>1,598</td>
</tr>
<tr>
<td>HHI Assets</td>
<td>629</td>
<td>664</td>
<td>678</td>
<td>741</td>
<td>794</td>
<td>796</td>
<td>813</td>
<td>813</td>
<td>779</td>
<td>808</td>
</tr>
<tr>
<td>Share of foreign banks, (%)</td>
<td>73.5</td>
<td>74.1</td>
<td>75.2</td>
<td>74.3</td>
<td>74.5</td>
<td>76.1</td>
<td>76.7</td>
<td>76.9</td>
<td>75.4</td>
<td>76.2</td>
</tr>
<tr>
<td>Assets (net), EUR m</td>
<td>24,015</td>
<td>25,211</td>
<td>25,322</td>
<td>24,827</td>
<td>24,545</td>
<td>25,059</td>
<td>26,253</td>
<td>28,440</td>
<td>31,931</td>
<td>31,960</td>
</tr>
<tr>
<td>Capital, EUR m</td>
<td>4,720</td>
<td>5,104</td>
<td>5,198</td>
<td>5,186</td>
<td>5,074</td>
<td>5,090</td>
<td>5,122</td>
<td>5,631</td>
<td>5,725</td>
<td>5,664</td>
</tr>
<tr>
<td>Loans (gross), EUR m</td>
<td>15,324</td>
<td>17,204</td>
<td>17,273</td>
<td>16,140</td>
<td>16,170</td>
<td>16,172</td>
<td>16,441</td>
<td>17,565</td>
<td>19,406</td>
<td>19,670</td>
</tr>
<tr>
<td>Of which gross NPL, EUR m</td>
<td>2,592</td>
<td>3,275</td>
<td>3,217</td>
<td>3,448</td>
<td>3,483</td>
<td>3,491</td>
<td>2,800</td>
<td>1,730</td>
<td>1,105</td>
<td>1,060</td>
</tr>
<tr>
<td>Gross NPL ratio, (%)</td>
<td>16.9</td>
<td>19.0</td>
<td>18.6</td>
<td>21.4</td>
<td>21.5</td>
<td>21.6</td>
<td>17.0</td>
<td>9.8</td>
<td>5.7</td>
<td>5.4</td>
</tr>
<tr>
<td>IFRS impairment of NPLs</td>
<td>47.2</td>
<td>51.0</td>
<td>50.0</td>
<td>50.9</td>
<td>54.9</td>
<td>62.3</td>
<td>67.8</td>
<td>58.1</td>
<td>60.2</td>
<td>61.3</td>
</tr>
<tr>
<td>Deposits, EUR m</td>
<td>14,263</td>
<td>14,584</td>
<td>14,936</td>
<td>15,067</td>
<td>15,637</td>
<td>16,523</td>
<td>18,242</td>
<td>19,926</td>
<td>23,115</td>
<td>22,919</td>
</tr>
<tr>
<td>Pretax Income(^2), EUR m</td>
<td>241.0</td>
<td>12.0</td>
<td>102.5</td>
<td>-18.0</td>
<td>29.0</td>
<td>80.0</td>
<td>172.0</td>
<td>579.8</td>
<td>640.6</td>
<td>280.0</td>
</tr>
<tr>
<td>CAR(^3), (%)</td>
<td>19.9</td>
<td>19.1</td>
<td>19.9</td>
<td>20.9</td>
<td>20.0</td>
<td>20.9</td>
<td>21.8</td>
<td>22.6</td>
<td>22.3</td>
<td>23.9</td>
</tr>
<tr>
<td>CET1 ratio (^3,4)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>21.5</td>
<td>21.1</td>
<td>22.7</td>
</tr>
<tr>
<td>Leverage (^3,4)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>11.1</td>
<td>12.6</td>
<td>13.8</td>
<td></td>
</tr>
<tr>
<td>Liquidity ratio</td>
<td>1.0</td>
<td>2.2</td>
<td>2.1</td>
<td>2.4</td>
<td>2.2</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
<td>2.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Liquidity coverage ratio(^4), (%)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>239.5</td>
<td>213.3</td>
<td>231.2</td>
</tr>
<tr>
<td>FX ratio, (%)</td>
<td>3.9</td>
<td>6.2</td>
<td>5.5</td>
<td>4.4</td>
<td>3.9</td>
<td>4.4</td>
<td>2.7</td>
<td>4.5</td>
<td>4.4</td>
<td></td>
</tr>
<tr>
<td>ROA(^2), (%)</td>
<td>1.1</td>
<td>0.0</td>
<td>0.4</td>
<td>-0.1</td>
<td>0.1</td>
<td>0.3</td>
<td>0.7</td>
<td>2.1</td>
<td>2.1</td>
<td>2.1</td>
</tr>
<tr>
<td>ROE(^2), (%)</td>
<td>5.4</td>
<td>0.2</td>
<td>2.0</td>
<td>-0.4</td>
<td>0.6</td>
<td>1.6</td>
<td>3.4</td>
<td>10.6</td>
<td>10.6</td>
<td>11.8</td>
</tr>
<tr>
<td>Net interest margin(^5), (%)</td>
<td>4.6</td>
<td>4.6</td>
<td>4.3</td>
<td>4.2</td>
<td>4.3</td>
<td>4.3</td>
<td>3.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.3</td>
</tr>
</tbody>
</table>

1. The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodina on 6 April 2013, from Privredna banka Beograd on 28 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK bank on 23 December, 2017. Pireaus bank was merged to Direktna bank on 26 October, 2018. Vojvodanska banka was merged to OTP bank 25 April 2019 (consolidated under Vojvodanska brand).

2. Without Agrobanka at the end of 2011: Pretax profit € 296m; ROA 1.2; ROE 6.0. Without Razvojna banka Vojvodina at the end of 2012: Pretax profit € 230m; ROA 1.0; ROE 4.7

3. The last available data of 31.03.2019

4. Introduced by the implementation of Basel 3 and monitored from 30 June 2017

5. Net interest margin to average total asset

---

The NBS revoked operating licence from Nova Agrobanka on 27 October 2012, from Razvojna banka Vojvodina on 6 April 2013, from Privredna banka Beograd on 28 October 2013, from Univerzal banka Beograd on 31 January 2014 and from Jugobank Jugbank Kosovska Mitrovica on 2 April 2018. The NBS issued operating licence to Mirabank on 16 December 2014 and the bank started its operations in April 2015. The NBS issued operating licence to Bank of China Srbija on 20 December 2016. The Findomestic bank was merged to Direktna bank on 1 July, 2017. Jubanka ad Beograd was merged to AIK bank on 23 December, 2017. Pireaus bank was merged to Direktna bank on 26 October, 2018. Vojvodanska banka was merged to OTP bank 25 April 2019 (consolidated under Vojvodanska brand).